Navigating Risk in Impact-Focused Philanthropy

This supplement was produced by *Stanford Social Innovation Review* for Open Road Alliance in partnership with The Rockefeller Foundation

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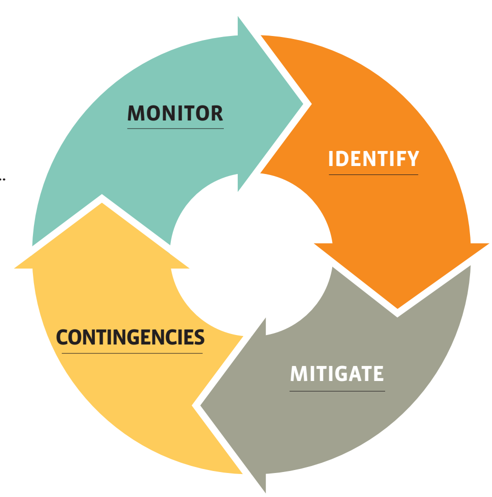

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A NOTE ON THE
RISKS OF RISK

Risk is tricky. Aside from the confusing (and sometimes conflicting) definitions and perspectives of risk that are discussed in the following pages—risk as a positive versus negative, risk as a subjective versus objective reality—dealing with risk is easier said than done.

This is because risk speaks to our core human emotions of fear, hope, skepticism, and confidence. What are you afraid of? What do you trust? And what scares you more, losing money or your reputation? In an environment with scarce resources and no right answers, every choice has trade-offs.

Even in the production of this supplement, we ran into several debates about whether certain examples were "too honest" and could jeopardize relationships; or whether focusing on the role of donors in risk management would push this fundamentally shared responsibility too far off nonprofits' plates, or ignore the personal agency and ownership of those closest to the work.

In fact, one of the risks with our entire endeavor of making risk "as commonplace in philanthropy as monitoring and evaluation" is that we—unintentionally—do more harm than good. I am personally dreading the day when a nonprofit tells me that a donor asked them to write a five-page risk assessment for a $5,000 grant, in the name of "risk management."

This supplement makes the express recommendation of policies, protocols, legal frameworks, and scenario planning, to help bring structure and logic to this messy process. Yet, we know that the fundamental success of these tools rests on human elements. Successful relationships, upon which all grantmaking ultimately depends, are impossible without trust. As nearly every article in this supplement notes, trust is hard to create and easy to lose. And the nemesis of trust is fear.

So, if there is one call to action after taking these perspectives into account, it would be to trust a little more and act on fear a little less. Try to be less afraid of telling the truth, asking for help, admitting mistakes. Work to replace doubt with trust and be less afraid of stepping into the unknown. Try accepting—if not embracing—the uncertainty inherent in our work.

By no means has our work on risk management reached its conclusion, and like most systems work, it likely never will. Yet we hope this can be the start of conversation and perhaps even the start of change. After all, when reminded of what we're facing—poverty, disease, conflict, environmental degradation, human rights abuses, and more—what have we really got to lose?

Maya Winkelstein
Executive Director, Open Road Alliance
Chair, The Commons

Embracing Philanthropy's Risky Business

Until risk management becomes common philanthropic practice, we will miss the boat on maximizing impact. Here's how to start developing the policies and practices you need.

BY LAURIE MICHAELS & JUDITH RODIN

There is a system failure in philanthropic practice that is diluting impact and costing funders potentially billions of dollars. The glitch? The absence of common risk-management practices as an integral part of the grantmaking process.

In its Summer 2016 issue, *Stanford Social Innovation Review* published an article by Open Road Alliance that highlighted this generally overlooked aspect of grantmaking, noting that there is little or no explicit and systematic preparation by donors for contingencies that might damage a project's success.

In 2015, Open Road conducted a survey, the results of which made plain the extent of the cross-sector avoidance of discussions about risk. Out of 200 randomly selected donors surveyed, 76 percent reported that they did not ask potential grantees about possible risks to the project during the application process. Grantees reported that 87 percent of the applications they filled out did not ask for risk assessments. Why is this of such critical significance? Here's why: Both funders and grantees surveyed estimated that one in every five grant-funded projects would encounter unexpected obstacles that derailed success.

What's more, even though funders acknowledged that 20 percent of their projects would likely be negatively affected by unexpected events, only 17 percent of those funders reported that they set aside funds for such contingencies. In short, although funders and nonprofits agree that 20 percent of our potential social impact is at risk, as a sector, most do nothing about it.

Laurie Michaels is founder of Open Road Alliance.

Judith Rodin is the former president of The Rockefeller Foundation.

To address this gap in philanthropic practice, we, as the founder of Open Road Alliance and the president of The Rockefeller Foundation, co-convened leaders from across the philanthropic sector to discuss practical methods for assessing and planning for risk. Composed of 25 members, the Commons is a geographically diverse group of practitioners including leaders of institutional and family foundations, law firms specializing in philanthropic governance and tax issues, financial advisory firms, and nonprofits of varying sizes and missions.

The Commons affirmed that the lack of open conversation about risk in philanthropy has a negative effect on funder-grantee trust and project impact. And through a six-month, consensus-driven process, with the support of Arabella Advisors, the group developed adoptable and adaptable policies for addressing risk and implementing risk-management procedures throughout the grantmaking value chain.

The Commons also developed a set of user-friendly risk-management tools that are applicable across the philanthropic sector and address issues that face funders of all sizes and types. (Recognizing the inherent power dynamic between funders and fund seekers, the Commons designed its first tool kit for funders, rather than for nonprofits, to use.) In this article, we offer a high-level look at the steps that a foundation might take to implement effective risk-management mind-sets and activities throughout its organization. The full set of policies and risk-management tools can be found at: www.openroadalliance.org/resource/toolkit

Defining Risk

About 15 years ago, funders generally stated "impact" as their goal, without any standard definition or best practices for impact measurement. The word was widely used but poorly understood. As such, its usefulness for our sector was limited. Now, there is a consensus about the differences between output, outcome, and impact; the words have distinct meanings, and therefore they're useful across the sector.

Today, we see "risk" in much the same way that impact was viewed 15 years ago. Many funders like to describe themselves as "risk taking," but in the absence of a common definition and frameworks for best practices, these statements are difficult to evaluate at best, and meaningless at worst.

Risk does have a straightforward definition: It is the likelihood that an event will occur that will cause some type of undesirable effect. These events can occur anywhere, anytime. They may be predictable or not, controllable or not, and caused by internal or external variables. The concept of risk sits on a spectrum, and identical events may be deemed more or less risky based on the viewpoint of the funder.

Moreover, while labeling something as a risk often implies the possibility of a negative effect, taking that risk can be a profoundly positive choice. While the existence of risk is a given, the choices one makes in the face of that risk are inherently subjective. Herein, then, is the basis of a core definitional distinction that would be useful for funders: risk *culture* versus risk *management*.

Risk culture refers to the concept of risk as a subjective choice and reflects an organization's appetite or tolerance for taking risks. Organizations that have thought through and codified the essential parameters that define their risk culture can bring internal and external clarity to the process by which they make choices regarding investments and grants.

In contrast, risk management is necessary to deal with the unavoidable existence of risk regardless of one's appetite or tolerance for it. Risk management is concerned with the reduction or avoidance of disruptive events, as well as risk-mitigation strategies and contingency planning. In grantmaking, risk-management practices are the steps that funders and nonprofits can take to reduce either the likelihood of a harmful event or the harmful consequence of that event. In both risk culture and risk management, there is no such thing as zero risk.

Even with the distinction between risk culture and risk management, a discussion of risk can quickly become confusing when we consider what is at risk. To maintain clear terminology and to help funders compare and prioritize different types of risk, the Commons proposes the following risk taxonomy specific to the philanthropic sector:

- *Financial risk*. Financial risk refers to the risk of losing money. Funders are sensitive to threats to the foundation's endowment and place a high value on protecting those investments. The Commons encourages funders to equally consider its programmatic dollars as investments where the return is measured in impact. This perspective inspires impact-oriented questions, such as "How much money are we willing to risk to achieve impact?" or "In what scenarios would we rather risk losing money versus losing impact?" This also prompts funders to consider how to protect the impact of the dollars already spent—for example, with a supplemental grant.
- *Reputational risk*. Reputational risk stems from events that cause a foundation to experience an embarrassment or threat to its brand. Funder appetite for reputational risk varies, but funders with a commitment to learning from failures and sharing those learnings tend to be more open to reputational risk.
- *Governance risk*. Governance risk refers to events that could affect compliance with legal, tax, or good-governance practices, such as conflicts of interest, inappropriate organizational structures, and inexperienced or unqualified boards. As with financial or reputational risk, a funder should not take a governance risk without simultaneous steps to mitigate that risk.
- *Impact risk*. Impact risk, also called execution or implementation risk, refers to events that negatively affect the intended impact of a given project. To the Commons, this is a critical area of risk for philanthropy, as risks to impact are threats to our sector's raison d'etre. Impact risk exists at the project level, the portfolio level, and the organizational level.

Evaluating and managing impact risk has been the primary focus of the work of the Commons, to date. Typically, it was also the type of risk that members had in mind when developing steps for implementing risk-management practices and strengthening risk culture throughout a foundation's value chain—from its board to the nonprofits it supports.

Understanding Risk Culture and Management

A foundation's board of directors or trustees has the primary responsibility with senior management to define and clarify the organization's risk culture and profile. Just as a board sets an acceptable level of financial risk with respect to its endowment or other investments, the board should set broad parameters for taking risk within its grants portfolio.

The accompanying chart offers a list of considerations and set of guiding questions designed to support a discussion that can help lead an organization to identify its risk profile. (See "Considerations Affecting Risk Appetite" below.)

These discussions are likely to be lengthy, as the board examines hypothetical scenarios, clarifies the balance of risk versus impact, and looks at the record of unsuccessful projects in the process of developing a risk-profile statement that provides core guidance for staff and grantees. Additionally, by examining their past practices, funders can ascertain whether their grantmaking and investments align with their ideal risk profile.

Defining risk culture is value neutral. Being risk averse is not objectively better than risk taking, and vice versa. In a similar vein, while risk often carries a negative connotation, it can also be a positive or even necessary idea in the context of risk culture. For example, innovation is dependent upon taking risk, and it is axiomatic that greater risk can often bring outsized results. It is the board's role and responsibility to give broad guidance to foundation staff regarding the acceptability of certain levels of risk.

While the board sets the course, the foundation's president and executive team actively steer the ship on a day-to-day basis. It is therefore the role of the leadership team to translate the foundation's risk-profile statement into common policy and practice. This is also where leaders can embrace risk as a pathway to learning, rather than approach it as a boogeyman to be avoided.

For the foundation to truly learn from risk and failure, its risk profile needs to become part of the organization's daily culture. Yet, we know that building culture is easier said than done. To increase the chances of success with this endeavor, the Commons recommends going beyond paper statements to model the desired culture in an intentional and deliberate manner.

To live your risk culture, the Commons suggests holding regular conversations with staff members about risk and failure. Talk about the foundation's core values, its risk appetite, and the right balance between risk and reward. Foundation leaders can get creative with the format and incentives aligned with such conversations.

For example, for many years, the William and Flora Hewlett Foundation held an annual contest on the "Worst Grant" or the "Worst Strategy." The intent was to create a new norm that embraced candid discussion about failure. While the contest outlived its usefulness,[1] its spirit is still a part of the foundation's culture of learning. From sharing evaluation results to hosting staff learning sessions on risk, the Hewlett Foundation aims to encourage dialogue about failures and missed opportunities in order to improve future outcomes.

Such approaches also begin to reframe conversations about failure to ones about learning. To this end, it may be helpful to evaluate a "failing" program in terms of how risk was managed. Rather than simply looking at outcomes, ask yourself, "Did we see this coming? If not, why not? What could we, as the funder, do to mitigate this risk in the future?"

Yet, when it comes to risk culture, internal conversation is not enough. In order to set expectations and help potential grantees to self-select, funders should communicate their risk culture externally. Consider posting your risk-profile statement on your website and including it in your request for proposals (RFPs) to help potential grantees and co-funders gain a better sense of whether your foundation is a good match for them.

Finally, be sure that other internal incentives, such as performance reviews, reflect the desired risk culture. Discuss risk management in annual performance conversations with staff members, and consider offering staff members incentives for taking smart risks, applying your risk profile to investment recommendations, exercising good use of contingency resources, and taking advantage of opportunities to learn from failure.

Even in the most conservative risk culture, risk will still always exist. Therefore, the work of the leadership team also involves setting policies and practices to mitigate the risk that is inherent in the everyday grantmaking process. In a comprehensive risk-management approach, these procedures would affect everything from budgeting to applications, due diligence, and monitoring and evaluation (M&E) processes. Two of the most critical policy items are budgeting for contingency funding and incorporating risk management into the RFP process.[2]

Budgeting for Contingency Funding

It's axiomatic that "risk minus cash equals crisis,"[3] and so financial structures are critical to help funders budget realistically for risk. The Commons recommends that funders set aside contingency funding as part of their standard organizational and grant budgeting processes. Since risk is relative, the size and scale of a given foundation's contingency resources will depend on its risk profile and therefore the kinds of projects in its grantmaking portfolio. To guide funders in determining the appropriate scope for contingency funding, the Commons recom-

Considerations Affecting Risk Appetite

Attitudes Toward Innovation and Failure	• Do you prefer to invest in innovative or tried-and-true methods? • Do you prefer to invest in new organizations or organizations with proven track records? • How comfortable are you investing in geographies that are new to your grantee? • What is an acceptable failure rate? What does failure mean to you? • How do you respond as a funder when your grant fails?
Risk Profile of Existing Portfolio	Looking at grants over the past three grant cycles or years: • What percentage were high-, medium-, or low-risk grants? • What percentage of grants went to startup organizations or pilot projects and what percentage went to established organizations or ongoing projects? • What percentage of grants failed? (Hint: If the answer is zero, you may not be getting the full picture of your grants.)
Budget Flexibility	• How often have you exceeded your annual grantmaking budget in the past? • How willing are you to provide additional mid-cycle funding due to unexpected events? • Do you (or do you plan to) set aside contingency resources at the project or portfolio level?
Internal and External Communications	• How often does your board and staff discuss risk management, failure, and the tradeoffs between risk and reward? • Do you communicate your risk profile openly among staff or external audiences such as potential grantees? • Do you ask about potential risks in RFPs and grant applications? • Do you facilitate open conversations about risk with applicants? • Do you work with applicants or grantees to mitigate risk before or during a grant?

Determination of Risk Appetite

mends building policies off of the following factors:

- If your foundation is investing in projects that have a higher number of unknowns or variables that can affect impact, it will likely require more contingency resources than if you are investing in better-understood efforts with long track records where the risks are more overt, quantifiable, and less likely.
- Assess how much of your portfolio is made of high-, medium-, and low-risk investments. If your portfolio skews toward high-risk grants to startup organizations and first-time planning, experimental, or learning projects, then you may need to set aside more contingency resources than if you typically fund well-established organizations and proven projects.[4]
- Analyze your grantees' financials. If your grantees tend to have less cash on hand and lower unrestricted net assets, then you will likely need a larger contingency fund. Conversely, nonprofits that are well funded with unrestricted assets may be able to cover their own emergencies through internal reserve funds.
- Poll your staff members to see how many contingency requests they received over the past year and the total dollar amount of those requests. Keep in mind that these figures may be artificially low if you have not historically had a policy or practice of contingency funding.

How to Build Contingency Protocols

The Commons Task Force encourages funders to map a clear process for managing and responding to contingency fund requests to ensure that they and their grantees know how to proceed when a request arises. This figure outlines the specific steps funders should consider when building out their own process.

Step 1	**SET ASIDE CONTINGENCY RESOURCES** Resources determine how much in contingency resources to set aside. The appropriate size and scale of funds will depend on factors such as your risk tolerance; breakdown of existing portfolio into high-, medium-, and low-risk grants; and overall grantmaking strategy. For a full list of guiding questions see: www.openroadalliance.org/resource/toolkit
Step 2	**ESTABLISH CRITERIA** Develop a list of criteria for evaluating requests for contingency funding. Possible criteria may include: urgency of request, the level of impact at risk for the project, the likelihood that contingency funding preserves desired impact, grantee's operational and administrative performance to date, confidence in grantee's ability to manage future risks, and the level of alignment with the type(s) of risk you are willing to cover.
Step 3	**ESTABLISH DECISION-MAKING PROTOCOLS** In your bylaws, outline decision-making protocols that clarify the roles your program director, executive director, board, executive committee, or fast-acting decision-making committee should play, as well as any specific voting procedures and the time line for making a decision. In the case of a fast-acting decision-making committee, your bylaws should outline who will serve on this committee, how it makes decisions, and the process by which one would convene a session.
Step 4	**COMMUNICATE PROCESS TO GRANTEES** Be sure your grantees know who to contact if they encounter a challenge with their project. Do this by including "in case of emergency" contact information (name, phone number, and email address) in grant agreements. As you are able, in your grant agreements clarify when grantees can anticipate a response to such a request and how long it typically takes to process contingency funds, if approved.
Step 5	**COMMUNICATE DECISIONS TO GRANTEES** Important information to share when responding to your grantee's request will include: the amount of contingency funding approved, when the grantee should expect to receive the funding, and any additional requirements or expectations (such as a subsequent narrative or financial report on how the contingency funds were spent). If the request is denied, provide the reasons for the denial, which will help grantees avoid bringing similar requests in the future.

Consider, for example, The Rockefeller Foundation's contingency budget structure. Here, the board and staff have created a flexible contingency budget structure in two ways. First, the board annually authorizes the president to go above the annual budget by as much as 5 percent to ensure the success of the foundation's initiatives. This discretionary contingency fund allows the foundation to move quickly in order to support grantees and initiatives that may be facing unexpected obstacles. Second, by working within an initiative-based strategy, the board also approves multiyear initiative budgets, which allows Rockefeller's executive team and CFO to manage the budgets in a portfolio rather than a grant docket approach. This enables the foundation staff to respond to unexpected needs and shift funds from one area to another.

Other, smaller foundations have employed simpler contingency funds by a variety of methods, including setting aside a flat 10 percent in the budget for emergencies, creating a fast-acting executive committee that can make rapid decisions and release additional funds, or asking each grantee to budget for contingencies in its own grant applications. Whatever the amount and method, once you determine the size and scope of your contingency fund, you will also need to develop the funding criteria and decision-making protocols to get that money out the door when needed. (For a breakdown of these steps, see "How to Build Contingency Protocols" above.)

Incorporating Risk Management into the RFP Process

Funders can help pave the way for more transparent exchanges with nonprofits about risk simply by including questions about risk in RFPs and grant-application forms. This step alone would represent major progress in planning for risk, since a staggering majority of funders do not ever ask what could go wrong that might require additional financial support. When funders do not ask, nonprofits do not tell because they fear that even raising the topic will jeopardize future funding.[5]

Sometimes, however, simply asking a nonprofit about risks that imperil impact does not generate enough useful information. The Commons recommends leading by example and starting the conversation by sharing the foundation's own risk profile in RFP and application forms. By including a risk-profile statement in RFPs, funders can help potential grantees understand whether or not their work aligns with the foundation's risk culture.

This risk-profile statement can be both broad and specific, including a description of your overall risk-appetite level as well as how that appetite may vary between specific program areas or portfolios. When crafting such statements, be deliberate in including the reasons and rationale of why you may have a low tolerance for one type of risk but a high tolerance for another. Remember that this culture side of risk is inherently subjective and that you'll need to clearly explain your perspective.

A risk-profile statement can also touch on topics related to risk such as how you define "failure" within your grant portfolio. This can be a good place to provide historical data on the makeup of your program investment portfolio (for example, a percentage breakdown of high-, medium-, and low-risk grants, restricted versus unrestricted funding, and amount set aside for learning grants).

Once the topic is broached, funders can inquire about risk on the grantee side by including at least one risk-related question in the RFP. Asking such a question opens a channel for a transparent conversation about risk, and the applicant's responses will help foundations assess whether a mutual fit exists. Possible questions that lend themselves to written responses include: What are the top three risks you may encounter during the course of this project, the steps you could take to mitigate these risks, and the ways in which we (as the funder) could help? What could happen to derail the intended impact of your project? What risks have you encountered implementing similar projects in the past, and how did you respond?

Both funders and nonprofits participating in the Commons' work underscored the fear, uncertainty, and frustration that often permeate the application process—in which nonprofits may spend weeks writing an application, often followed by months of silence from the funder. In such a scenario, nonprofits acknowledge that they may not be fully forthcoming on a written application, even if the funder asks.

For this reason, it is important for funders to follow up the written application with a verbal discussion of risk with grant applicants. The program officer should be clear that the conversation is about risk mitigation and management, rather than a test for flaws. Sample questions that lend themselves to a productive in-person interaction include: When you consider this project, what worries keep you up at night? What obstacles do you foresee with project implementation? What could I do—either now or down the road—to help you mitigate risks to impact?

Lastly, reviewing a nonprofit's financials is just as important for risk management and contingency planning as it is for due diligence. When reviewing financials from a risk-management perspective, there are a few approaches that can particularly help.

The first is to review any project or organizational budgets in the grantee's original format. Understanding how the finances are organized by the grantee itself gives much better insight into a grantee's financial acumen than having it populate a pre-made template.

Another risk-management approach is to review the balance sheet for assets and liabilities, specifically with an eye toward seeing the amount of unrestricted net assets held, as these assets are often the only source for nonprofits to provide their own contingency funds. Similarly, while most funders request budgets, many may not have insight into a grantee's cash flow projections for the next 12 months.[6] Looking at cash flows in addition to budgets or balance sheets is critical to assessing fundraising and spending trends. Understanding where a potential grantee may face cash flow crunches will allow you to better time your gift to avoid being the source of a crunch or to possibly alleviate anticipated shortfalls.

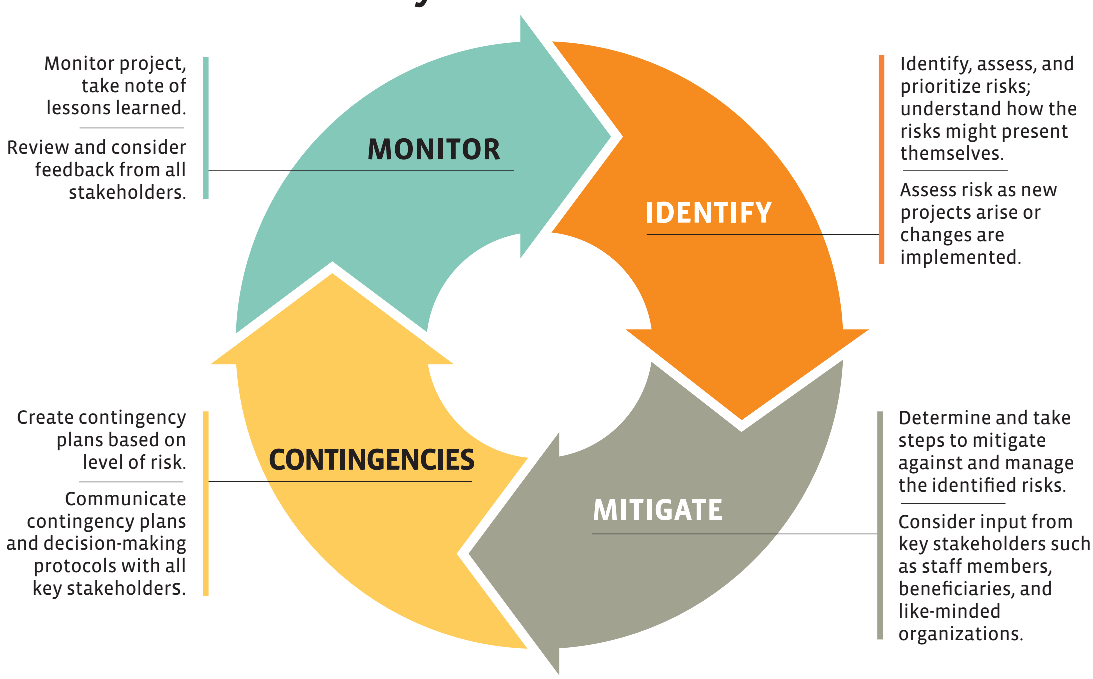
Once the application process is complete, steps similar to those outlined for an RFP process can be implemented for monitoring, evaluation, and reporting procedures. Like M&E, risk management is a continuous learning process that involves identifying, mitigating, planning for contingency, and then monitoring and reassessing risks as projects move forward. (See "The Risk Assessment Cycle" below.)

In fact, funders should consider aligning their M&E processes with the level of risk anticipated for each portfolio or project. This would mean continuing to engage grantees in conversations about risk throughout project implementation and tailoring the frequency of these exchanges to align with anticipated risk.

The recoverable grants team at Open Road Alliance developed a Risk Scorecard to facilitate this process. The Risk Scorecard assesses individual grants across a range of roughly 30 pre-identified risk factors, which include balance sheet strength, liquidity, management quality, operating methodologies, country risk, and regulatory risk. Categories are weighted according to Open Road's risk profile and preferences.

Based on qualitative and quantitative assessment, each recoverable grant is then assigned a "risk level category," which determines the extent of monitoring and reporting that is required. For example, leaders of a project in the lowest-risk category would need only a 30-minute phone call with the portfolio manager once a quarter, whereas those heading up projects in the highest-risk category might be asked to submit monthly financials and accommodate an in-person site visit from the funder

The Risk Assessment Cycle



every quarter. During these check-ins, risk levels would be reassessed, and scores would be shared and discussed with grantees.

From application to final report, foundation leaders can set both the policy and the tone to make risk management a more regular and normative part of the grantmaking process.

Building Effective Funder-Grantee Relationships

While including risk in an application is a critical first step, the partnership between a funder and a nonprofit does not live on paper; it lives in relationships and is strengthened by the phone calls, e-mails, and site visits between program officers and nonprofits. Though it is not often thought of in policy terms, the Commons believes that ensuring transparent, honest, and effective communication between funder and grantee is both the hardest and highest form of risk management. To underscore this point, our survey research showed that only 52 percent of nonprofits feel comfortable discussing problems that occur mid-grant with a funder.

Funders can do much to foster an atmosphere that encourages nonprofits to be transparent about possible risks to impact by enabling their program officers to exercise greater discretion. In the tool kit, the Commons recommends some specific grantmaking practices that can help foster greater trust and transparency, such as increasing unrestricted funding, providing multiyear grants, and streamlining the application process for repeat or long-term grantees. However, in the case of funder-grantee communication, we recognize that there is no simple checklist or paper-based protocol that can get to the heart of building strong relationships.

Rather than considering such suggestions as mere policy changes, the Commons encourages funders to consider how they can allow the people closest to the action to meet their grantees' needs more flexibly and thereby ensure and insure the intended impact of the grant. In some cases, creating the space for agency and flexibility will involve more change in culture than paper-practice. For example, one of the often-cited concerns of nonprofits participating in the Commons (and echoed by nonprofits in Open Road's portfolio) is that funders "don't truly understand" the context they are working in. It's important to note that the nonprofits in question weren't referring to a lack of policy knowledge or experience with a relevant regulatory framework. Rather, their comments are much more relational in nature and more akin to a perceived lack of empathy than just "understanding."

To tackle this issue, funders can take steps proactively to understand the daily challenges of their grantees' work. Funders can encourage staff to get involved with a nonprofit organization outside of their role as a funder. Experiencing "the other side" builds empathy and may better position funders to have open conversations about risk with grantees.

Finally, remember to approach all risk-management practices as a two-way conversation. Ask potential grantees to provide input to risk assessments, and give them an opportunity to review the assessments after completion. Without grantee input, mitigation strategies cannot be effectively considered or implemented.

Many of these suggestions don't represent anything particularly new in the conversation about grantee-centric and partner-based approaches to philanthropy.[7] To the Commons, however, these behaviors are not just "nice"; they're necessary for comprehensive, effective risk management. Without partnership, funders have only a list of potential problems, not a path forward to solutions. Risk-management policies themselves are not enough. It is how they are used and communicated by frontline staff that determines how effective your risk-mitigation efforts will be.

What's at Stake

Philanthropy in the United States is a $373 billion industry,[8] and the absence of risk management results in lower impact per dollar spent. Roughly 61 percent of grant-funded projects that encounter obstacles and cannot access contingency funding end up reduced in scope or terminated, a percentage of waste that is unacceptably high.[9] That represents nearly $43 billion in grant dollars per year that could have either no impact or less impact than originally planned. And this is far more than a policy discussion; when projects are terminated or reduced in scope, the people who depend on these programs lose vital services. Risk management in action preserves impact for vulnerable populations and ecosystems.

Philanthropy has evolved to insist on valuing and measuring impact, which makes it ripe for the next level of professionalization and sophistication. And current trends—in the quantification of impact and results-based financing—make the need for better risk management more pressing, even imperative. Within philanthropy, we are seeing unprecedented intergenerational wealth transfers,[10] the creation of new philanthropic models, and a new generation of foundation leaders, all seeking to reimagine how we can most effectively achieve impact. There is a growing appreciation in the sector that funders must pursue a more explicit partnership between those who have the money and those who have the capacity to generate impact.

Meanwhile, inequality is growing, and financial markets are facing more uncertainty than ever before (if also their highest levels of profit). The lines between the private and nonprofit sectors are increasingly blurred, and external events continue to shape the barriers we face as impact seekers.

All these variables make the need for a robust discussion and practice of risk management imperative to our sector. We know that at least one in five philanthropic investments is affected by unpredictable variables. Until guidelines based on historical evidence and shared expertise are put in place, and until those guidelines lead to risk-management practices as a common philanthropic practice, we will miss the boat on maximizing impact. A stronger risk culture, and better risk management across our sector, will enable us to create greater impact and increase the effectiveness of every dollar deployed for social good. ◀

NOTES

1 June Wang, "Forgetting Failure," *Stanford Social Innovation Review*, March 22, 2016.

2 To review all seven tools related to risk management, please visit www.openroadalliance.org/risk

3 Clara Miller, "Risk Minus Cash Equals Crisis," NCRP State of Philanthropy 2004.

4 Certain high-risk strategies, such as challenge grants or venture philanthropy models, may make the deliberate choice not to have contingency funds, as the purpose of the strategy is to fail fast.

5 Open Road Alliance Survey: 47 percent of grantees surveyed said they believed that asking for additional funds affected the likelihood of being awarded future grants.

6 Many nonprofits may not have cash flow projections as a preexisting report, and producing one could exceed the organization's abilities or be an outsized burden. Funders should understand where their grantees sit and right-size their requests accordingly.

7 For more on the conversation about grantee-centric philanthropy, see Peery Foundation, Grantmakers for Effective Organizations, The Whitman Institute, and others.

8 Donations from US individuals, estates, foundations, and corporations reached an estimated $373.25 billion in 2015; Giving USA Survey, 2015.

9 Drawn from ORA 2015 Survey on Risk in Philanthropy.

10 Over the next 30 to 40 years, $30 trillion in assets will be passed down in North America alone, according to Accenture's report "The 'Greater' Wealth Transfer: Capitalizing on the Intergenerational Shift in Wealth."

CASE STUDY

Managing Risk to Scale Impact

Can expecting the best, but planning for the worst, prepare nonprofits and their funders to turn unexpected roadblocks into opportunities?

BY ERIC STOWE

We like to think of nonprofit organizations as the brave wayfarers of broad social change, scoffing at risk and thirsting for the opportunity to "go big" as they relentlessly pursue their missions. But with more than 10 million NGOs operating globally—and still a seemingly endless list of problems to tackle—it strikes me as fair to question the validity of that view.

In fact, from my vantage point, it seems that most nonprofits have little appetite for risk.[1] Small, one-off initiatives, isolated pilot projects, village-level programming, or limited-scope endeavors are the norm, not the exception. While that approach, often seen through proofs of concept, shouldn't discount their efficacy, impact, or worth, these programs rarely ever go to scale.

A big piece of the issue, of course, is the availability of big-bet funding. The expressed desire for transformative change from the donor community has never been greater than it is right now. And increasing numbers of grantors *say* that they would like to see third sector organizations take big risks. But funding opportunities are far from commensurate with that ambition. In fact, investments are actually quite sparse relative to the level of attention and zeal the funding community has placed on systems change and big bets over the last few years.[2] In any case, taking on major social initiatives without clear pathways to success, as it turns out, seems to be a difficult thing to do with other people's money.

What could change this picture? Besides a complete overhaul of how NGOs and donors engage with one other when thinking of and planning for broad social change, here's what I think could be a good first step: more frank discussion about risk—the nature of it, how to anticipate and prepare for potential crises, and what to do in the event of one. It has become common to hear axioms about organizations taking big risks when working toward big change, but it's rare to hear what doing so actually looks like on the ground. By acknowledging and having a plan to deal with risk, grantors and NGOs alike can feel more comfortable in making calculated big bets.

That's why I have written this essay—to share my experience with risk as founder and CEO of Splash, a nonprofit committed to ensuring safe water for children and families worldwide. In a nutshell, I've learned that the bigger the goal, the greater the potential for a fairly unremarkable event to become a fairly monumental challenge or crisis. So when I hear funders talk about organizations taking bigger risks, my question is this: Is the organization built to withstand a crisis, and is the funder ready to support the organization in the event of one? Because whether or not its leaders and staff members have triple-checked every line item and every moving part of their program, if they are working toward real scale, then real crisis is inevitable.

What follows are descriptions of three specific times when we at Splash had to assess our goals and strategies in response to unforeseen and sometimes calamitous events—events that radically altered our organizational vision and posed existential threats to our programs if not handled strategically. In all three cases, our donors played a critical role in helping us to effectively deal with potential crises and chart a path forward.

China: Our (Almost) "Mission Accomplished" Moment

Splash's first major project launched in China in 2007. Due to a strong preexisting working relationship with the government there, we were able to initiate an expansive project focused on providing safe water to every orphanage in the country—there were 700 on our list—in relatively short order. With China's geographic size and cultural complexity across its many regions and provinces, it was a mighty task—especially when you consider that at the time, Splash was an agency of two people. But we poured everything into the project's success, and we saw fast returns.

You can imagine my unbridled joy when we were close to completing the project in 2012. With only 20 orphanages left on our checklist until 100 percent coverage, you can also probably imagine my unfiltered shock when the government informed us that there were actually more than 500 orphanages still left on the national roster, facilities that hadn't been included on our original list.

Keep in mind: We had already done the bulk of fundraising for the initial target and therefore had reallocated our fundraising attention and resources to other programs; we had widely discussed the projected completion date publicly, which allowed us to initiate new donor conversations for new initiatives based on the success of this soon-to-be completed accomplishment; and we had begun planning a celebration with key donors of the program, which had been scheduled to be completed on time. To hear that we were barely beyond the halfway mark was absolutely crushing, to say the least.

In the government's defense, the facilities that the officials had left off the list were the most sensitive and remote orphanages in the country, and until they were sure that we weren't there to politicize or proselytize under cover of our license, they hadn't been willing to share them. In our defense, we honestly didn't know about these facilities, as they were truly the most protected and remote of the country's orphanages—off the grid completely from common view. In the end, we were provided an unprecedented level of access into the government's child-serving programs because we had proven ourselves across the country over the previous five years.

While I take pride in the level of trust we earned, the news caused an immediate and monumental crisis within our organization. We were committed to serving *all* of China's orphanages. But the immense funding deficit we faced; the barrage of questions from staff, board members, and donors about our seemingly anemic project planning (even though we were transparent about what had happened); and the acute concern that our reputation was at stake, all collided to raise serious doubts (ours, our donors', our other clients') about our abilities to reach this new milestone goal.

Eric Stowe is CEO of Splash.

Once we decided to stay true to our goal of reaching 100 percent, we ended up approaching our largest funder and pitched them to ease previous funding restrictions on other grants to Splash. In so doing, we were able to ease the strain on the organization while also allowing for flexibility in moving capital toward areas of greatest need rather than toward rigid business plans built in a vacuum.

It is only now, five years later, that we are mere months from completion. It wasn't easy to course-correct our work in-country, or to revise Splash's programming outside of China to help ease the financial and operational burdens placed on our organization with the addition of the 500 orphanages (for a new total of 1,200). In fact, it took at least three years to relearn our rhythm and regain our pace in China, to divert resources toward rebuilding our fundraising efforts, to reassign people throughout our organization to newly revised work plans, and to restructure our global plans to ensure that we could meet the needs of all the countries we had committed to helping.

Without the flexibility of our primary donors, we would have had to choose between collapsing the China program and significantly downsizing other country programs to stave off organizational entropy. I honestly shake my head when thinking about how much we had to reshuffle to keep this program in China on track.

India: Too Much of a Good Thing

Our work in India is similar in audacity to what we set out to accomplish in China. Here, we're determined to ensure clean water, clean hands, and clean toilets for 400,000 of the poorest kids across 2,000 government schools in Kolkata, the nation's third-largest city.

Most people have a hard time imagining what a water crisis looks like in an urban setting. This is even true of government officials who live and work in the same cities in which we operate. We have routinely found that officials working in the Education, Health, and Water ministries in India are unaware of how unhealthy and unsafe the water, sanitation, and hygiene (WASH) conditions are in poor urban schools. To change that scenario, we shifted our funding strategy in 2015 to invest significant resources in collecting deep data around this subject—knowing that providing evidence of the critical WASH situation in urban India was critical to mobilize everyone concerned about schoolchildren and their education.

We took extensive measures to ensure that our data collection process and findings were unassailable.[3] We spent several months in Kolkata and in two other locations, sending teams to every public school to assess the WASH infrastructure, evaluate the schools' existing WASH knowledge and programs, and test the drinking water on site. In total, we reached more than 3,000 schools providing education for more than one million children. The data we gathered showed a dramatic gap between what public officials believed the WASH standards to be and what they actually were.

Our findings inspired our teams, compelling us to reframe our own strategies and our programming. So it shouldn't have come as a surprise that when we presented our data to the representatives of various ministries in India, and other NGOs and international NGOs (INGOs) interested in the same issues, over a four-month span, they were shocked by the results.

Specifically, once the stark conditions at these schools were spotlighted, global INGOs, Indian organizations, and government bodies with a vested interest in education, urban poverty, and WASH began approaching us, proposing potential partnerships that would stretch our work well beyond our original targets in Kolkata—and even beyond our planned focus on improving conditions in schools. Many of the groups that approached us were significantly larger than Splash (by several orders of magnitude).

These were much bigger organizations pitching a much smaller and far more resource-constrained organization to partner on initiatives that would see meaningful revenue increases for us but would also require an appreciable stretch in both our scope and services. We realized that in order to align with these new co-funding opportunities, we would have to expand our model to accommodate the other organizations' broader scope of work, speed up our growth and outputs exponentially, and carry a much greater fundraising burden.

The power dynamics associated with the negotiations, the internal discussions we had about the decisions we would have to make in order to control mission drift, the speed in which the agreements had to happen (before the opportunities dried up)—all intersected very quickly. And in the end, we simply couldn't keep up.

Not only did we lose momentum overall, but also we actually lost some credibility in the marketplace because we were talking about operating at scale, but we were not necessarily ready to implement in such a multidisciplinary fashion. What had begun as a groundbreaking chance to spend our resources to prove the need ended up as a protracted situation that tested our ability to maintain our clarity of purpose. All of the opportunities in front of us had great potential but also could have pulled us from our core focus, and they certainly could have diminished our ability to deliver for the core communities we had committed to serve. It was a prime example of how even the most positive developments still present risks.

Ultimately, we decided to refocus on our core commitment to design a scalable WASH-in-Schools model for Kolkata that could be replicated across India's major cities and beyond. We moved forward with one critical strategic partnership and deepened the support of one of our key donor groups to take advantage of this opportunity. Today, thanks to their support, we have been able to build internal expertise at our Seattle headquarters, in India, and in our two other main program countries, Nepal and Ethiopia, paving the way for broader future success and far greater scalability.

Now, with our core program model strengthened, we will be selectively reengaging with the global INGOs, Indian organizations, and government bodies to reassess opportunities for partnership, with a clearer perspective on mission creep and greater leverage in negotiations.

Nepal: Doing the Right Thing—and Getting Punched Anyway

In Nepal, we're focused on ensuring safe water for all of the schools in the nation's capital city of Kathmandu. In keeping with our long-term goal of transferring full control and autonomy to local country offices over time, we decided to invest heavily in the professional development of the local country leader, a smart, charismatic, engaging, and entrepreneurial individual. Between 2013 and 2015, Splash spent significant resources, influenced our networks, and committed funding to build his leadership capabilities.

By early 2016, Splash was closing in on ensuring clean water for 70 percent of all the students in the city. We estimated that it would take an additional two years to get to 100 percent coverage, and we were ramping up for the final leg of implementation, with a larger goal of seeing our model replicate in cities across the country in our sights.

Then we learned that our country director, the same one in whose development we had invested so heavily, had been caught consolidating control over our commercial relationships in Nepal. Shell companies were presented as legitimate vendors, existing policies and procedures were ignored, financial documents were manipulated, and funds from new donors to Splash were being rerouted to this individual's personal business. He was gaming to reap substantive personal gain from our philanthropic projects.

We pride ourselves on building our model for plagiarism, but not in this way!

These revelations were shared with donors to the program in real time (sharing internal findings within hours of receiving them at the organizational level), which compelled two of Splash's largest funders to hit "pause" on their funding to us while we tracked all the possible routes of malfeasance. With the assistance of local auditors, lawyers, and business consultants, we were able to determine the extent to which this man had manipulated the policies, opportunities, and relationships that we had built together.

Fortunately, the staff in Nepal alerted us before this individual's actions caused an irreversible loss. Still, this situation cost us at least a year of momentum and put a pause on more than $1 million in expected funding. Being blindsided in this way was harder for us to overcome than any of the other disruptions we had experienced in Nepal, including those caused by the continuous political upheavals there. Recovering from the fallout of this one person's actions was even more difficult for our organization than rebounding after the massive earthquake of 2015.

At the time, we were spending more than 35 percent of the organization's funding on our work in Nepal. The precipitous drop in revenue that followed this unfortunate discovery effectively slammed the brakes on everything we were doing in the short term and forced us to alter our long-term plans as well. It placed enormous strain on our local staff of 30 in Nepal, on our relationships with the government and with schools there, and on our relationships with donors in the United States and Europe. It also taxed our team and our operations in Seattle.

Globally, we are now a much stronger agency because of what happened. The reactions of key donors helped us make the decision to push pause on this program and take the steps necessary to strengthen our management structure in Nepal. The bent toward spotlighting the individual social entrepreneur (the Heropreneur, as we think of it internally) was a dogmatic and ill-conceived philosophy to begin with, but an approach all too common in the social sector.[4] This learning transferred quickly to our other program countries and areas, to the benefit of all our work. While we count ourselves lucky to have caught it when we did, in Nepal we have had to spend a lot of time rebuilding relationships because of what transpired. Trust is built slowly, but it can be destroyed in a flash.

The Butterfly Effect

Strong government partnerships, data-driven programming, and deep investment in local leadership are all essential to the scale and sustainability of any nonprofit venture. We wholly subscribe to them all, even though they ultimately exposed us to significant risk in China, India, and Nepal.

But that's part of the process, right? Isn't it what we all signed up for? All nonprofits face a barrage of unforeseen threats (or organization-changing opportunities) on a regular basis. And for those truly pushing the boundaries in the social sector, the risks and opportunities can multiply 10-fold. The greater the goal, the higher the probability that a small action will someday trigger an exponentially larger reaction. In other words, the deeper you go into systems change, the greater the butterfly effect. But all of it—the good, the bad, and the blind side—leads me to three primary conclusions about risk.

First: To be durable, an organization must be built with the expectation that it will have to survive crises. It has to have a responsive and adaptive leadership team that is ready to shift resources, divert and manage funding, and mobilize staff to focus on (potentially) entirely new paths—all while retaining the social fidelity of the organization and navigating to the same North Star. The organizational muscle memory associated with navigating crises well is a net positive for any major future investment. Not every shock or surprise leads to a negative outcome, though. Far from it. And being prepared for a crisis doesn't necessarily suggest a work atmosphere of constant frenzy; that's not healthy anywhere. But the team at the helm of the ship has to be agile enough to course-correct quickly in the event that lightning does strike, and do so with efficiency, integrity, and accuracy.

Second: Organizations must be swift, honest, and transparent in conversations with their donors as challenges arise, not after they've become too big to handle. Too often, organizations attempt to show that they've solved a budding issue, and by the time it has morphed into something more difficult, funding partners are belatedly informed. In each of the three cases I described, we reached out to key funders very early on in the process of assessing the shifting landscapes. Most said that they had never been given that sort of visibility within such a short time frame. This led to totally different discussions between real partners, rather than the usual transactional discussions between donors and grantees. If anything, we now have deeper relationships with each of the funders that were associated with the three cases.

Third: Organizations need to build their capital reserves so that they will be able to weather the unexpected major storm. Open Road Alliance recommends a reserve of at least 20 percent of the overall project costs to mitigate significant risks throughout the life of the project. Judging from our experiences in China, India, and Nepal, that figure seems appropriate. For us, funding allocation and reallocation became the critical linchpins holding programs together in times of tumult *and* opportunity. Were it not for the cash reserves we had built up, coupled with unrestricted funding, support, and guidance from progressive donors, any of these projects, in isolation, might have slid inexorably off the rails. Progressive philanthropists would also do well to accept that with any transformative project there will be a corresponding likelihood of risk associated with their investments. Thinking about how to set aside a percentage of grant funds to help NGOs deal with crises and opportunities would be both prudent and visionary.

It just goes to show that risk and reward do go hand in hand, and that planning for risk is an approach that donors *and* nonprofits can rally behind. ◀

NOTES

1 There is no shortage of amazing, risky, and transformative interventions by tenacious, talented, and fearless organizations. But if you took every group ever featured by Ashoka, Skoll, Acumen, Schwab, Clinton Global Initiative, TED, and other award-making funders, and multiplied that by 100, the final tally would still be minuscule compared with the 10 million NGOs that operate around the world.

2 Bridgespan has done some tremendous work on this topic. One of their important findings is that most large donations go to institutions—such as universities, hospitals, and museums—not to social sector causes.

3 Splash worked with multiple global development organizations to design a survey capable of spotlighting critical gaps in urban WASH; we curated the final assessment tools with the relevant government bodies overseeing education in those cities, and we paid premium rates to hire third-party enumerators and third-party water-quality laboratories to undertake the surveys.

4 http://tacklingheropreneurship.com

Change Is Worth the Risk

To use risk as an instrument for progress, funders need to see it as a means for continuous learning.

BY MAURICIO MILLER

Martha, a mother of three in Boston, was on welfare, which meant that her special needs child, Ruben, was eligible for a subsidized assisted care program. She wanted to get off welfare and was able to secure employment. When her income went up, however, she discovered that her income was above the eligible threshold for assisted care, so Ruben was immediately dropped from the program. The problem? Even with her new job, Martha didn't earn enough to enroll Ruben in a comparable private program. So her choices were stark: She could either quit her job and get back on welfare so that her son could continue in the program (where he had been thriving) or find another way to build a future for her family that didn't include welfare—or Ruben's program.

These sorts of complicated, personal, painful situations arise every day for people utilizing safety net programs. After more than 50 years of "the war on poverty," the most we can claim in terms of victory is that we have made poverty "tolerable" for a portion of the population—for parents who qualify for public housing or whose children qualify for a Head Start program (or, as in Ruben's case, a much-needed specialized care program). But even for those who can access these benefits, living in "tolerable poverty" was never the goal. How could it be?

It's true that many existing efforts to address poverty are looking to expand their scope and reach. Food pantries and homeless programs are looking to add workforce training services; housing programs are encouraging long-term residents to become upwardly mobile; and schools are trying to encourage more parents from low-income families to get more involved in their children's education. These new efforts will inherently involve some level of risk in the hopes of greater impact; nonetheless, their leaders forge ahead.

Yet, afraid to lose funding, many more social sector service programs try to avoid risk by making only small adjustments to existing approaches. Current economic development and workforce training programs are tweaking agendas and processes that were implemented as far back as the 1970s. Bigger changes are needed, and to support them, risk needs to become an integral part of the model for change.

Our sector's affinity for innovation and social entrepreneurs reflects a system-wide recognition of the need for change. However, when ideas are novel, we tend to back away. We need to be able to offer a greater tolerance and even an *appetite* for risk so that we can learn from the lessons that trial and error provide.

Using Risk as an Instrument for Improvement

To use risk as an instrument for progress, it needs to be seen as a means for continuous learning—the most promising path to developing effective solutions. For too long, the social sector has relied on longitudinal evaluations and control group studies. For example, often a program is designed, sold to a funder, and strictly implemented for a number of years; and then an evaluation firm is brought in to assess the success or failure. Risk is thus minimized (at least in theory). But improvement and the chance for real innovative breakthroughs are also minimized.

Private businesses would not survive this way. The most successful businesses use data gathering and analytics technologies to assess their work continuously, so that they can make ongoing adjustments as needed to improve. Those businesses, whether they're giants, like Amazon, or lean startups, are structured to adjust their products or their marketing according to what they are learning. Most nonprofit and government initiatives are not set up to do that kind of sophisticated, ongoing evaluation for the purpose of mid-implementation adjustments. But that can change.

We have the ability to get continuous feedback on progress—or failure—as an initiative or program is rolled out, and it doesn't have to be an expensive prospect. My project, the Family Independence Initiative (FII), has an online data collection and social networking system that others can plug into for nominal fees. For those enrolled in the dozen cities working with FII, we get monthly feedback from families about what steps they are taking to improve their own lives. We identify and make available a range of benefits or resources *based on that information*, and we track the progress—or faults—of what we're doing, and make adjustments as we learn more. Technology now makes it possible to gather the data, do the analysis, and quickly adjust our tactics to ensure that we're serving the people we work with as effectively as possible.

For instance, in working with low-income, micro-business owners, FII found that those seeking to expand their businesses were more interested in acquiring resources for medical care, childcare, or paid family time for themselves and their employees than in seeking funds to put directly into their core business operations. We learned that for entrepreneurs who are not privileged, ensuring that their family and the families of their employees are secure, healthy, and stable is the priority in their business development. Few programs that are meant to catalyze entrepreneurship in underserved communities address this need at all and are therefore ill-equipped to provide sufficient support. Our lesson has been to provide more flexibility on how families utilize funds we provide. But we also know that a tremendous amount of learning is still needed.

Risk is often perceived as a negative in program implementation, especially when resources are constrained and there seems to be little room for error. However, to make real progress in the war on poverty, or any other area of social impact, some level of risk not only is a necessity but also can be an asset. Certainly, there may occasionally be a novel approach that doesn't result in the desired outcome, but those ventures yield sector-wide learning and improvement if the right information about them is gathered, analyzed, and shared. More critically, for every risk that doesn't pay off, there are interventions that are successful—and often on a larger scale than programs that advance through incremental change. Funders must drive the promotion of a risk-tolerant environment so that service agencies testing new models are able to make real, sustainable progress.

Without taking risks, poverty will be tolerable, not escapable. It's time we bet big. ◀

Mauricio Miller is the founder and president of the Family Independence Initiative.

Risk, Trust, and Impact: Connecting the Dots

To promote innovation, support risk. To support risk, first build trust.

BY JANE WALES

Trust is the United States' most valuable asset. It provides the societal glue on which our democracy and our well-being rely. Without it, we cannot manage the dangers we face, nor steward the resources we share. Without it, we cannot solve large problems together.

However, a large percentage of the public reports that they do not trust our government, and, perhaps more worrisome, that they often doubt the good intentions of others in our society. This mistrust reflects a longer-term trend, driven in large part by the information revolution and the accompanying bursts of digital media that favor the scandalous over the significant. But the trust deficit need not become a permanent feature of our democracy.

To rebuild trust, we will need to leverage our unique form of self-governance, in which the public, private, and philanthropic sectors each have a complementary role. Leaders from all three sectors can join forces to strengthen social capital, advance societal cohesion, and model collaborative problem-solving behaviors across sectors, disciplines, and even ideologies. Ideally, the solutions they identify, either individually or in combination, will reflect the best qualities that each sector brings to the table: the transparency and accountability of democratic governments, the efficiency and scale of the private sector, the agility and responsiveness of nonprofit organizations, and the risk appetite and long view of philanthropies.

The goal is so weighty and the task so urgent that each sector must be at the top of its game in order for their combined efforts to succeed. But is our sector—philanthropy—primed to deliver? Unfortunately, the current answer to that question may be "No."

Is Philanthropy Too Wary?

Consider: The sector's advantages are clear. Free from the exigencies of quarterly reports and the press of a 24-hour news cycle, foundations are unique in their capacity to absorb risk and maintain a long view. The nonprofits they support are purpose-driven, nimble, and close to the customers who are the beneficiaries of their work. At a time of dwindling trust, these civil society organizations are widely accepted as legitimate vehicles for citizens to share knowledge and engage in collective action.

Its relevance is established. Most Americans have been touched positively by a charitable institution—whether it be a nonprofit hospital, a community center, a place of worship and solace, the American Society for the

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Prevention of Cruelty to Animals, the local PTA, or the American Civil Liberties Union. Most have received a service from, given to, volunteered for, or know someone who works for a nonprofit. These are organizations that are trusted and relied upon in our daily lives.

Its intentions are known. In performing these philanthropic services, many in the social sector have worked to set and adhere to standards of transparency that go well beyond those required by law. Charitable organizations, foundations, and nonprofits alike actively share what they do, what they spend, and what they learn, for among their goals is the advancement of field-wide learning. In addition to sharing evidence of success or failure in their publications, they make public information about the business of philanthropy in their tax returns, their annual reports, and their various governance documents. Transparency and therefore trust between citizen and nonprofit, government and foundation, is a hallmark of philanthropy's role in society. That openness contributes to their legitimacy.

But here's the thing. Despite their shared commitment to transparency and learning with the wider public, grantors and grantees are often wary of one another, and that wariness can stand in the way of conversations about the level of risk each is willing to assume. Grant-seekers are loath to dwell on the difference between a "sound bet" and a "sure thing" for fear of scaring away a cautious donor. And grantmakers, intent on results, sometimes leave little to the discretion of a new grantee.

In short, when it comes to acknowledging, embracing, and managing risk, the charitable sector may lack the kind of trust for each other that it advocates for in society as a whole.

Do as I Say, Not as I Do

That was the supposition put forth by The Commons, a multistakeholder effort that brought together more than 20 leaders from the philanthropic sector to better understand risk in giving, and better understand what stands in the way of trust and transparency between foundations and nonprofits.

In my experience, grantmakers and grantees continuously confront a trust divide, with some very understandable reasons. After all, one seeks the resources that the other controls. The playing field is never level, and that fact inevitably introduces tension that can discourage frank admissions about the level of risk each is willing to take on. Therefore, the two sides rarely have a candid conversation about methods for risk management.

This mistrust results in abbreviated conversations between grantors and grantees that focus solely on the positive aspects of whatever engagement is on the table, rather than on the possible risks involved. Donors don't ask, and grantees don't tell. But the fallout of not discussing the risks inherent in a project is the greater level of mistrust that is created when something unexpected and negative happens during implementation (as it often does). Funders feel blindsided when a project hits a barrier or derails; nonprofits may end up abandoned by their partner at a time when they need support the most. There is plenty of room in such circumstances for either side to perceive itself as being mistreated.

My goal in joining The Commons was to home in on what it would take for more philanthropies to extend and receive greater trust from their nonprofit partners, and, depending on their risk tolerance, to gamble on a high-risk project that may offer a higher return. How smart is the risk culture? How smart can it be? How capable are donors and grantees at risk management? How can we improve that capability?

To begin answering these and other questions, we first turned to a survey conducted by Open Road Alliance in 2015 that revealed that grantmakers rarely ask grant applicants what could go wrong with their projects over the life of the grant. Their grant negotiations focus instead on how a prescribed logic model might drive certain results, rather than on the possibility of unexpected hazards along the way—dangers that could derail the project altogether. In fact, while foundations surveyed for the study reported that 20 percent of projects are compromised or even derailed by an unanticipated occurrence, only 17 percent of foundations surveyed set aside funds for such contingencies. As a result, the grantees could be starved of flexible resources at the very time they are most needed.

As noted in the resulting report, "All members of The Commons agreed that one of the most fundamental aspects of risk management lies within the funder-grantee relationship itself. Research shows that one of the primary barriers to successful risk management is a lack of transparency and trust between funders and nonprofits. ... While managing risk is a shared responsibility, funders are in a unique position to implement practices that foster an environment that allows nonprofits to be more transparent about possible risks to impact and more trusting of funders as partners for impact."

Ultimately, we developed five specific recommendations[1] for funders. We believe that by following these recommendations, funders will build levels of trust with their grantees in short order. With higher levels of trust comes better tolerance for risk and management of risk. More risk tolerance and better risk management will lead to innovations that can make a lasting dent in solving our social challenges.

Here are the five recommendations:

- Lead by example—develop and share a "risk profile statement" to guide program officers and potential grantees alike.
- Start the conversation—include a conversation about risk in requests for proposals and grant application forms, signaling an understanding that risk resides in everything, and formally creating an opportunity to explore and reveal one another's risk appetite.
- Be accessible—provide emergency contact information to all grantees. This way, if they need to check in when an unforeseen opportunity or barrier arises, they can do so swiftly. By providing this communication channel, funders signal their expectations that not all things can be predicted.
- Encourage program officers to develop empathy for nonprofit managers by encouraging them to serve on nonprofit boards. Move away from the tradition of hiring academics as program officers; opt instead for those with nonprofit experience of their own.
- Build nonprofit resiliency, by making capacity-building a goal and by explicitly supporting that goal.

This is a delicate moment in history; if our faith in existing institutions continues to decline rapidly, our capacity as a society will be reduced commensurately. The challenge of building social capital is a hard one, requiring an all-hands-on-deck approach. The charitable sector is an essential contributor, for it has maintained the popular trust. With this toolbox in hand, grantmakers can do even more to help their grantees realize their full potential, and to ensure that we deliver what we promise, truly to the best of our abilities.

There is much to gain, and it is well worth the risk. ◀

NOTE

1 From "Risk Management for Philanthropy: A Toolkit," The Commons.

Q&A WITH

James P. Joseph and Tomer Inbar

Understanding and managing the legal risks associated with a foundation's programmatic work can help increase the likelihood that that work will have impact.

Foundations and other nonprofits tend to view legal compliance as the final step in building an impactful program, and they often wait until the last minute to bring in legal counsel for a green (or red) light. Too often, this positions legal counsel and program staff as adversaries, rather than partners in creative and impactful program design. But it doesn't have to be that way. To better understand how lawyers can be impact-focused partners and help foundations and their program officers plan for and manage risk, **Maya Winkelstein** from Open Road Alliance sat down with two seasoned lawyers, **Tomer Inbar**, a partner at Patterson Belknap Webb & Tyler LLP, and **James P. Joseph**, a partner at Arnold & Porter Kaye Scholer.

Maya Winkelstein: ***In your experience, what are the practical ways that a lawyer can help a foundation keep the impact of its programmatic work on track?***

Tomer Inbar: At a basic level, a lawyer can keep impact on track by having insight into the mission, personality, and operations of an organization. This allows a lawyer to be a creative problem solver and better understand how to communicate about issues a client may face early in the program development cycle so that compliance isn't an obstacle to impact at the end. We view legal compliance as freeing, enabling people to go where they want programmatically without creating risks or issues. And as lawyers, we try to get our clients to understand legal compliance in the same way. Legal compliance should be viewed as a component of achieving impact, and the earlier on a lawyer is brought in, the more helpful we can be in ensuring program development.

James P. Joseph: It's also important for us to remember that as lawyers, giving advice that is practical and useful is important. We don't want to set up a legal system for a client that is so complex that it impedes people from doing their job. Yes, there are legal rules that have to be followed, but a critical part of our job is to help an organization understand what legal risk the organization can take, or needs to take, to achieve its mission.

Legal compliance should be viewed as a component of achieving impact, and the earlier on a lawyer is brought in, the more helpful we can be in ensuring program development.

TOMER INBAR

Inbar: Absolutely. Having an onerous legal and internal compliance system that is ignored is far worse than having a more targeted system that is actually put into practice. Lawyers need to work with an organization to understand and make clear the risks that absolutely need to be focused on, and then build a practical program from there.

Why should lawyers care about impact if their fundamental job is to protect the foundation?

Joseph: It is a false premise to say that a lawyer's fundamental job is to protect the foundation. A lawyer's job is also to protect the mission of that organization, and one part of that is not putting them at legal risk. And at the same time, it may be the case that if you are 100 percent protected from risk, you may not be very effective programmatically. You may not have the impact that you want while maintaining a conservative risk profile. There is inherently going to be some level of risk in anything that a charity does.

Inbar: Even by using the word "protect," it sounds like we are protecting the foundation from itself or stepping in between it and a problem to ensure compliance—as though we are separate from the organization. I don't think of myself so much as protector, but rather as someone working with an organization to help it achieve its mission.

What do you do when the culture of a foundation you are working with has taken on a risk profile that doesn't reflect legal reality?

Joseph: I've realized how infrequent it is that people discuss a risk profile in a straightforward way. So, in working with clients, I've started being more direct and asking, what is your risk profile? Are you comfortable taking a risk, or do you want to take as little risk as possible? If there are any gray areas around compliance, where do you want to fall? For example, if a foundation is funding a project that includes advocacy, that may or may not constitute lobbying. There are many activities that do not clearly fit outside of the definition of lobbying, but they also do not fall clearly within the definition. Some clients won't go near a project like that, but others want a defensible position. They don't want to play cute with the rules, but they are willing to go closer to the line. It's important for a client to know their risk threshold, because there is a relationship between risk and impact—if we go up the scale on risk mitigation and ensure the highest level of legal compliance, the potential for impact may go down. That's why having conversations about risk and compliance on the front end of programmatic development can help shape impact.

Inbar: There can be times when an organization's risk tolerance is unnecessarily conservative. And that may just be the organization's personality. But I do think it's incumbent on the lawyer to try to challenge an overly conservative risk profile. A lawyer can work with his or her clients or programmatic counterparts and lay out different ways to achieve impact that the organization may not have considered because they didn't know how to navigate legal compliance or they are concerned with creating legal complexity. A lawyer can help achieve impact by moving the institutional culture. The law in and of itself can't do that.

What are some of the challenges that lawyers might face when they attempt to contribute to a foundation's programmatic impact?

Joseph: I find it most challenging when clients want to compartmentalize lawyers from programmatic impact because they see them as separate. In my view, that is not effective or efficient; you have to, from the beginning, combine program and compliance. When the lawyers aren't brought in until the very end, you can run into compliance roadblocks, which often ends up being more expensive for the client.

Inbar: Too often, lawyers aren't seen as partners in a foundation's mission. When you make a differentiation between program and compliance, it's a false distinction that doesn't help anyone achieve their common objective. But when we are brought in as a part of programmatic development, we can help remove hurdles to impact from the beginning.

What advice would you give to lawyers about how to start the conversation about risk with their programmatic counterparts? And conversely, how can a program officer start the conversation about risk with their legal counsel?

Inbar: It is important that both parties understand where the other is coming from. A lawyer has to fully understand what a program team is hoping to accomplish, and the best way is to have face-to-face conversations. While meeting in person is more time and effort than exchanging emails back and forth, having real dialogue not only helps with mutual understanding, but increases trust. These conversations then allow a lawyer to be more flexible and creative. Lawyers who don't have a full picture of an organization's programs, or are less experienced, can often give very rigid advice in order to err on the side of caution, which can affect impact. But when you really consider what a program team is trying to accomplish, it allows for creative problem solving so that compliance and impact aren't in tension.

It is a false premise to say that a lawyer's fundamental job is to protect the foundation. It's also to protect the mission of that organization, and one part of that is not putting them at legal risk.

JAMES P. JOSEPH

Joseph: When lawyers understand a program team's goals and what the planned steps are, they can anticipate obstacles and help an organization accomplish its goal. Counsel might just suggest a slightly different course to get them there—one that better manages legal risk.

What other advice do you have for foundations and their legal counsel as they think about, and attempt to better manage, risk?

Joseph: Formulating a very clear risk profile is incredibly helpful in guiding program development—it can be a much more practical framework for an organization to work within rather than vague legal concepts.

Inbar: I would emphasize that legal issues inform business issues. So, while lawyers are certainly there to work on the legal issues, not bringing them into the business practices of an organization is a mistake. As lawyers, it's important that we have a full picture of what we're giving advice on, since the advice we're offering has to work in the real world.

Joseph: As lawyers, we can offer different business paths. We can identify paths that may have one or two legal issues versus ones that might have dozens. Bringing us in as part of the team while programs and plans are developing allows us to advise on the best course of action from the outset.

Using Scenario Planning to Surface Invisible Risks

Is your organization prepared if the unexpected should come to pass?

BY SAMPRITI GANGULI

Over the past year, we have witnessed a wave of largely unexpected sociopolitical events with important implications for the social-impact sector: Brexit, the US presidential election, the rise of nationalist movements globally, and the surge in charitable giving. In the wake of these events, many funders and grantees are wondering what they could or should have done differently—both to predict these events and to respond to them more quickly. While not a panacea, better scenario planning can help funders become more agile and responsive to unexpected events.

Scenario planning—developing a range of story lines about how the future will unfold—is a creative exercise that enables an organization to evaluate how programmatic outcomes and eventual overall impact might vary under differing conditions. In contrast to traditional strategic planning, scenario planning typically works on a longer time horizon, well beyond an annual or three-year plan. It also encourages participants to acknowledge the possibility that the future may hold circumstances that are not necessarily the most probable, but are plausible and include less desirable or even negative outcomes.

The scenario-planning process enables a team to think through a range of possible strategic options, identify triggers for strategic choices and key inflection points, and develop risk-mitigation plans. When practiced regularly, over time, scenario planning enables an organization to reallocate resources and make other significant decisions more rapidly than they would otherwise have, when a "plausible but unlikely" event actually comes to pass.

Scenario planning came into vogue in military intelligence in the 1950s, and the technique has been part of some corporate strategic planning processes for decades. For example, Shell Oil Company's scenario planning predates the oil crises of the 1970s and in some ways helped that company's leaders to better prepare their organization for those shocks. In another case, United Parcel Service began a significant expansion into the retail store market based off a scenario that its leaders developed, known as the "Brave New World," that imagined a vastly different regulatory environment.[1]

The practice became more popular after the credit crisis of 2008, the impact of which was felt throughout global economies. Retrospectively, many in the risk-management field referred to the 2008 meltdown as a "black swan,"[2] echoing an expression that dates back to ancient Rome. It once implied impossibility, since black swans were thought not to exist, but when a black swan was sighted in Australia in the late 1600s, the expression evolved to imply that what once was thought impossible might someday be proved.

Consider that idea for a moment—the possibility that what we now regard as impossible, or highly unlikely, might be proved a reality. That's the fundamental psychological leap that effective scenario planning requires and enables: thinking through possibilities we have yet to even imagine, internalizing the idea that such unexpected outcomes could actually happen, and then envisioning what it would take to respond in such circumstances. Scenario planning requires us to believe that black swans exist, even if we've never seen one, and even if we are far more likely to keep meeting swans that are just like the ones we've seen before.

Why Scenario Planning Is Difficult for Donors

Scenario planning is an excellent way to prepare for the unexpected. But in order for donors to execute the practice well, they may need to confront and overcome a host of structural and cultural barriers.

First and foremost: Risk management is not common practice at most foundations. As Open Road Alliance's research shows, during the grantee application process, roughly only one in four funders openly discusses impact risk (defined as the chance that something may go wrong that damages the project outcomes) with prospective grantees.[3] If most of us don't even consider probable obstacles to our programs, then we are unlikely to push ourselves to consider the most unlikely outcomes.

Second: The short time horizons of most grant cycles discourage both donors and grantees from thinking about the longer term. The relatively tight timeframe in which most grants deliver funds (and donors expect results) emphasizes reliance on recent history to predict the short-term future. This process leaves all parties vulnerable to being blindsided by the unexpected.

Third: Grantees are often capacity constrained (and donors can be capacity constrained by choice), rendering scenario planning more in the "nice to have" rather than the "need to have" category.

And finally: The inherently subjective nature of the inputs and outputs in scenario planning may make this type of exercise challenging in foundations where the culture and operating norms are highly analytical and methodologically driven.

What Donors Could Be Doing

The benefits of scenario planning are worth the effort involved, however, and it should become a standard exercise in any philanthropic organization that plans to be making investments 10 to 20 years from now. The world is changing too quickly for it not to be.

How then would scenario planning look in a foundation setting? In a large foundation, or even in a small foundation where there are distinct areas of expertise on issues (and, potentially, issue silos), program officers in different areas would ideally meet annually to imagine alternative scenarios and explore how the issues they represent can and might intersect across grantee organizations or among target beneficiary populations. Program officers and groups of grantees could do the same, to great effect. Groups of program officers from different foundations, who were focused on one specific issue area, could also benefit from such an exercise.

Whatever the specific permutation of participants may be, here's what the exercise could look like in three steps (set, for discussion purposes, to focus on a hypothetical early learning program).

1. Analyze Megatrends | A foundation focused on early learning might start by brainstorming three to five hypothetical future megatrend scenarios that could affect early learning programs in a particular geography.

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A megatrend is a large-scale pattern or movement—covering a 10- or 20-year period—that has a major, long-lasting impact on business and society.[4] Megatrends can be social, economic, geopolitical, environmental, or technological. Their purpose, as part of scenario planning, is to encourage big-picture thinking that goes well beyond programmatic design and current theories of change and to "prime the pump" for a conversation around unthinkable outcomes.

For a program focused on early learning in public schools, for example, possible megatrends might include the privatization of public school systems, massive population displacements resulting in unprecedented increases in students (like what many Texas and northern Louisiana schools faced following Hurricane Katrina in 2005), or the abolition of federal oversight.

Identifying these megatrends could be done workshop style, where participants read a select group of provocative articles before meeting to prime them for lively discussion. Or it could be done by inviting in futurists or other speakers to highlight actual long-term societal trends that could fundamentally alter the course of a particular program or issue area.

2. Give Assumptions a Stress Test | Following the discussion of big-picture megatrends, participants would home in on the linkage between the implications of various megatrends, current programmatic priorities, and potential gaps. This step takes relatively abstract, or even far-fetched, ideas and develops them to see if they are, in fact, plausible.

This process also generally uncovers inherent biases, reveals interdependencies between circumstances that might have, at first glance, appeared unrelated, and potentially showcases blind spots that hinder acceptance of alternate futures. Here, one blind spot might be the unshakable belief that private schools will never emerge as the predominant way of educating students. Another might be the belief that philanthropy can never bridge the financial gap of a loss in public sector funding. Revealing these beliefs or assumptions can illuminate the systematic biases that underlie perceptions of a program's potential success (or failure).

One way to generate a more active conversation at this stage would be to have a facilitator pose the following questions:[5]

- What potential discontinuities in our programmatic environment could create new threats and opportunities?
- Assume for a moment that the future of our program progresses so poorly in the next decade that there is only one chance in 10 that it could be worse. Describe that future. What external developments or actions on our part led to it?
- What factors, elements, or considerations that made our program successful in the past do we need to forget in order to be successful a decade from now?
- Describe a scenario in which our board of trustees defunds our program. What do we need to do to guard against this?

3. Develop a Set of Specific Scenarios | With megatrends identified and some assumptions articulated, participants would next develop a set of scenarios that presented the feasible future(s) for the organization. The idea here is to generate multiple scenarios in an attempt to set a range of uncertainty (between two and four scenarios are usually sufficient). One scenario might be "End of an Era," where family foundations cease being the prominent platform for philanthropic giving. Another scenario could be "Idyllic Summer," which imagines a near-perfect policy, funding, and technical capacity support for public school education across the majority of states.

Exercises like these benefit from each participant having a clear role to minimize groupthink. As an example, one person can be the designated naysayer, another can be the optimist, a third participant can be the pragmatist, and the like. The idea is to develop scenarios that challenge the organization's conventional wisdom about the future, that are structurally different from one another, and that encompass positive as well as negative possibilities.

While there are many different tools to help generate scenarios, one of the simplest is to use a two-by-two analysis that juxtaposes the possible extreme outcomes of two major risks. For example, in the area of education, the two risks could be the level of government intervention (mapped from low to high) and the rate and possible direction of technological innovation (mapped from low to high). These vectors would be the basis for four possible scenarios. As participants developed each scenario, they could consider the following questions:

- How does our organization's theory of change fit in each of these alternative futures? Will our theory of change work?
- How do the alternative scenarios challenge assumptions on which we base our theory of change?
- How strong is our theory of change, given future possibilities?
- What would we need to modify in our theory of change to make it effective in these alternatives?

With the scenarios developed, participants would then consider their likely impact on the program or the foundation, and develop remediation and response plans for each.

How Can Scenario Planning Amplify Impact?

There are some downsides to scenario planning. It can be resource intensive, particularly for institutions that haven't done it before. And it is also inherently subjective and can be beset by biases (which is why I recommend the second step, to flush out and confront bias and assumptions to the extent possible).

But if funders and others in the social sector do increase our use of scenario planning (as I hope we will)—and if we then take the next step and share the scenarios we explore more broadly, we can push the entire field forward. As a heuristic tool, scenario planning has the potential to make programs more resilient and encourage bolder thinking within foundations. With shared results, we can help others do the same; our outcomes, after all, are interconnected. Scenario planning can help us all uncover previously unknown vulnerabilities or underappreciated strengths, significantly enhance mitigation, allow the sharing of information across programmatic silos, and increase responsiveness to rapidly changing external conditions.

Given the pace of innovation, the power and potential of digital access, and the growing reach of philanthropic capital, there's never been a better time to incorporate scenario planning as a technique to strengthen already-sound social change programs. ◀

NOTES

1 Shardul Phadnis, Chris Caplice, and Yossi Sheffi, "How Scenario Planning Influences Strategic Decisions," *MIT Technology Review*, Summer 2016.

2 Popularized by Nassem Nicholas Taleb's well-timed 2007 book *The Black Swan: The Impact of the Highly Improbable*, New York City: Penguin.

3 *Risk in Philanthropy: Funders Don't Ask & Non-Profits Don't Tell* (2015 Survey Report), Open Road Alliance.

4 David Lancefield, Robert Vaughan, and Richard Boxshall, "How to Seize the Opportunities When Megatrends Collide," *Strategy+Business*, Spring 2015.

5 I recommend engaging a facilitator so that individuals don't feel defensive about current programmatic priorities.

OPEN ROAD

KEEPING IMPACT ON TRACK

Launched in 2012, **Open Road Alliance** is a private philanthropic initiative that supports non-profits and social enterprises after they have encountered an unexpected obstacle. It provides the fast, flexible, contingency funding that's often not available in traditional grantmaking structures. With a portfolio of more than 80 investments, and counting, Open Road is developing an expertise on philanthropic risk—and a theory on what can be done to mitigate it. The organization's goal is to make managing risk as commonplace in philanthropy as it is in business. To accomplish this, Open Road conducts research, collects data, and shares best practices for the assessment and management of risk with the goal of protecting the integrity and impact of the original project. To learn more, please visit www.openroadalliance.org.

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For more than 100 years, **The Rockefeller Foundation**'s mission has been to promote the well-being of humanity throughout the world. Today, The Rockefeller Foundation pursues this mission through dual goals: advancing inclusive economies that expand opportunities for more broadly shared prosperity, and building resilience by helping people, communities, and institutions prepare for, withstand, and emerge stronger from acute shocks and chronic stresses. To achieve these goals, The Rockefeller Foundation works at the intersection of four focus areas—advance health, revalue ecosystems, secure livelihoods, and transform cities—to address the root causes of emerging challenges and create systemic change. Together with partners and grantees, The Rockefeller Foundation strives to catalyze and scale transformative innovations, create unlikely partnerships that span sectors, and take risks others cannot—or will not. To learn more, please visit www.rockefellerfoundation.org.

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